No. 20,966

IN THE

United States Court of Appeals

For the Ninth Circuit

RICHARD L. CHARTRAND,
Appellant,

vs.

BARNEY'S CLUB, INC., a Nevada corporation,
Appellee.

Appeal from the United States District Court for the District of Nevada

BRIEF OF APPELLEE

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JURISDICTION

Appellee, plaintiff below, brought suit against appellant, defendant below, in the Second Judicial District Court of the State of Nevada in and for the County of Washoe, praying for specific performance of an agreement to sell 240 shares of the capital stock of Barney's Club, Inc., a Nevada corporation, including an additional 15 shares which were in dispute, for the sum of Two Hundred Thousand Dollars ($200,000.00). (Tr. 6.) Defendant below answered and counterclaimed for specific performance of a

pre-incorporation agreement (Tr. 50), to which plaintiff below replied, (Tr. 57.) Petition for Removal to the United States District Court for the District of Nevada was filed on November 1, 1963, on the grounds of diversity of citizenship and the jurisdictional amount being in excess of Ten Thousand Dollars ($10,000.00), exclusive of interest and costs. (Tr. 3.) At the inception of the trial on November 23, 1965, plaintiff moved for a dismissal of its complaint with prejudice which was granted (Tr. 86), and the trial proceeded without a jury upon the issues raised by the counterclaim and the reply thereto. At the conclusion of the trial, the court held in favor of plaintiff below. Findings of Fact and Conclusions of Law (Tr. 67) were filed on December 29, 1965, and Judgment entered in favor of plaintiff on the same date. (Tr. 67.) Subsequently, Finding No. 7 was amended by the court and the amended finding was filed on February 8, 1966. (Tr. 87.) Timely Notice of Appeal was filed on March 9, 1966. (Tr. 90.) Statement of Points was filed on April 6, 1966. (Tr. 94.) The Transcript of Record was filed in this court on April 19, 1966.

This court has jurisdiction of this appeal pursuant to 28 U.S.C., § 1291, to review the judgment of the United States District Court for the District of Nevada.

QUESTION PRESENTED

Whether the court below correctly decided that the corporation had not adopted or ratified the pre-incor-

poration agreement and that therefore, the defendant below was not entitled to specific performance of 15 shares of the capital stock of Barney's Club, Inc.

SUMMARY OF ARGUMENT

Promoters of a corporation do not represent the corporation in any relation of agency or have any authority to enter into preliminary contracts binding upon the corporation. Therefore, a corporation is not liable upon any contracts which promoters attempted to make for it prior to its organization unless the obligation is assumed by the corporation's own act or acts after organization is completed. If a corporation, with knowledge of the pre-incorporation contract, accepts the benefits thereof, it will be required to perform the obligations incident thereto. However, ratification or adoption will not be presumed or inferred even where a corporation has received benefits under the pre-incorporation contract, unless actual knowledge of such contract is made to appear. The knowledge of the promoters cannot be imputed to the corporation. Even if we assume for the purpose of argument that knowledge of the pre-incorporation agreement can be imputed to the corporation, such imputation is negated by any action which the corporation takes which is in conflict with the pre-incorporation agreement, particularly where the defendant is a party to such action.

ARGUMENT

KNOWLEDGE OF PROMOTERS CANNOT BE IMPUTED TO THE CORPORATION.

The court below made a finding to the effect that where the corporation accepted benefits, knowledge of the pre-incorporation agreement would be imputed to it. (Tr. 89.) Appellee does not concede that that is the rule of law. The following cases have held that the knowledge of the promoters cannot be imputed to the corporation. Am.Jur.2d, §§ 119, 122 and 123. *Commercial Lumber Co. v. Ukiah Lumber Mills,* 94 Cal. App.2d 215, 210 P.2d 276; *Gardiner v. Equitable Office Bldg.,* 273 F. 441 (C.A. 2d), 17 A.L.R. 431; *Abbott v. Limited Mut. Compensation Ins. Co.,* 30 Cal. App.2d 157, 85 P.2d 961; *Fred Macey Co. v. Macey,* 143 Mich. 138, 106 N.W. 722; *Chapman v. Sky L'-Onda Mut. Water Co.,* 69 Cal.App.2d 667, 159 P.2d 988; *Tuttle v. Geo. A. Tuttle,* 101 Me. 287, 64 A. 496; *Murry v. Monter,* 90 Utah 105, 60 P.2d 960; *Bryan v. Northwest Beverages, Inc.,* 69 N.D. 274, 285 N.W. 689, 123 A.L.R. 717; *Ramsey v. Brooke Co. Bldg. and Hotel Assoc.,* 102 W. Va. 119, 135 S.E. 249, 49 A.L.R. 668; *Williams v. McNally,* 39 Wyo. 130, 270 P. 411.

In the *Commercial Lumber* case, cited above, the court said:

> "Plaintiff's contention that there was an implied ratification of the contract by the defendant corporation is likewise untenable. Lyons used part of the $15,000 received from plaintiff to pay for the construction of the mill and to buy timber which was turned over to the corporation. Thereafter he caused stock to be issued therefor which

became a liability upon the books of the corporation. The fact that the permit from the Corporation Commissioner specified that the shares be sold for cash does not affect the situation as between plaintiff and the defendant corporation. Plaintiff loaned $15,000 to Lyons upon his credit. At the time the transaction was entered into Lyons had not acquired the corporation and therefore was not its agent. The agreement was signed by him individually. Thereafter Lyons turned over certain assets to the corporation, including the lumber and the balance of the $15,000 he had borrowed from plaintiff and he received therefor 125 shares of stock.

"Furthermore, even had the corporation received the benefits of the contract, ratification will not be presumed unless the corporation had actual knowledge of the specific contract out of which the benefits arose. Rideout v. National Homestead Ass'n, 14 Cal.App. 349, 351, 112 P. 192; Abbott v. Limited Mut. Compensation Ins. Co., 30 Cal.App.2d 157, 163, 85 P.2d 961. The only person having actual knowledge of the transaction was Lyons. Bateman testified he had no knowledge of the contract at any time and when at his request Lyons submitted a financial statement of the corporation in September, 1946, it contained no reference to the contract or any notation of any indebtedness due to plaintiff from the defendant corporation. Lyons' knowledge of the transaction cannot be imputed to the corporation. The knowledge of a director who is directly interested in the contract is insufficient to charge the corporation and knowledge of a pro-

> moter who subsequently becomes a director cannot be imputed to the corporation. Abbott v. Limited Mut. Compensation Ins. Co., supra; Kiefhaber Lumber Co. v. Newport Lumber Co., 15 Cal.App. 37, 41, 113 P. 691."

In the *Abbott* case cited above, 30 Cal.App.2d 157, 163, 85 P.2d 961, the court held that to prove that a corporation adopted a promoter's contract engaging services of an attorney before the corporation was incorporated, evidence must show some affirmative act by the corporation from which adoption may be inferred, and receipt of benefits from the performance of the contract, without actual knowledge of its terms, or knowledge of a director directly interested in the contract is insufficient to charge the corporation. Knowledge of a promoter who subsequently becomes a director cannot be imputed to the corporation to charge the corporation with the adoption of a contract made by the promoter prior to the incorporation.

In a Federal case decided in the Second Circuit, *Gardiner v. Equitable Office Building Corp.,* 273 Fed. 441, C.A. 2d, 17 A.L.R. 431, the court held that there is no liability on the part of a corporation for services rendered by its promoters in effecting the organization, even though they were rendered under expectation of payment, in the absence of express promise by it after its organization, unless such liability is imposed by charter or its general laws. It was argued in this case that the defendant corporation had the

benefit of the pre-incorporation agreement and is therefore impliedly bound by it. In reply to this argument, the court said:

"So far as this argument is concerned, it is enough to say that, to make the principle applicable, the corporation must have accepted the benefits with knowledge of the facts. All of the cases which recognize the doctrine so hold. And there is no evidence in this record that the corporation knew of the agreement made by DuPont in the Andrews letter. It is true it is said that two of the directors, DuPont and Dunham, had actual knowledge of the letter at the time of the taking over of the enterprise by the defendant. So far as the knowledge of DuPont is concerned, it is clear that it was not imputable to the corporation. A corporation is not charged with notice of facts known to a director in a transaction between him and the corporation, in which he is acting for himself and not for the corporation. Davis Improved Wrought Iron Wagon Wheel Co. v. Davis Wrought Iron Wagon Co. (C.C.) 22 Blatchf. 221, 20 Fed. 699; Commercial Bank v. Cunningham, 24 Pick. 270, 276, 35 Am.Dec. 322; Burt v. Batavia Paper Mfg. Co., 86 Ill. 66. The general rule that the knowledge of the agent is imputed to the principal rests upon the presumption that the agent will disclose what it is his principal's business to know and the agent's duty to impart. But the rule does not apply where the agent contracts with his principal, because in such a case there is no reason to presume that the agent will impart information which it is for

his interest to suppress. The knowledge of a promoter is not to be imputed to his corporation. Machen, Corp. § 348."

The above rule was again discussed in a California case cited above, *Chapman v. Sky L'Onda Mut. Water Co.,* 69 Cal.App.2d 667, 159 P.2d 988, in which the court had this to say:

". . . The option contract, and the other contracts above mentioned, were not made in the name of the corporation, but were entered into by Crary and in his name for his own private purposes. It must be remembered that promoters are not the corporation, and that their contracts do not necessarily bind the corporation even though, after the subsequent organization of the corporation, they become the sole directors or officers. The rule, amply supported by authorities, is stated as follows in 6A Cal.Jur. 300, § 156:

'A corporation cannot be held liable for the acts of its promoters nor be obligated by their conduct and contracts towards or with others in the absence of * * * adoption of such conduct or contracts by the corporation after it comes into existence. The reason for this rule is that the promoters are not the corporation and their contracts cannot be its contracts, and this is so, even though the promoters become, upon the creation of the corporation, its sole stockholders, directors and officers * * *

'Ratification will not be presumed even where the corporation has received the benefits, unless actual knowledge of the specific contract out of which the benefits arose is made to appear.' "

ASSUMING FOR PURPOSES OF ARGUMENT THAT KNOWLEDGE OF THE PROMOTERS OF THE PRE-INCORPORATION AGREEMENT IS IMPUTED TO THE CORPORATION, ANY ACTION TAKEN BY THE CORPORATION AND DEFENDANT WHICH IS IN CONFLICT WITH THE PRE-INCORPORATION AGREEMENT NEGATES SUCH IMPUTATION.

The court below, in its order on defendant's Motion for a New Trial, amended its Finding No. 7 to impute knowledge of the pre-incorporation agreement to the corporation. (Tr. 89.) However, the court stated:

> "This amendment does not, however, change the Court's opinion and judgment. It is true, as argued by defendant, that although a pre-incorporation agreement is not ipso facto binding upon the subsequently organized corporation, if the corporation, without more, accepts the benefits of a pre-incorporation agreement with knowledge of its terms, it inferentially adopts the agreement and is bound by it, and no express adoption is necessary. But there is more to this case than that. Here the corporation adopted resolutions which were in conflict with the pre-incorporation agreement and these resolutions were ratified by Chartrand in his applications to the Nevada Gaming Commission. In other words, the evidence refutes the inference of adoption by the corporation of the pre-incorporation agreement which acceptance of benefits would otherwise justify. Of the many Court decisions cited by counsel in their helpful memoranda, this case is akin to Murry v. Monter, Utah 1936, 60 P.2d 960, where a corporation was held not bound by a pre-incorporation agreement in conflict with corporate resolutions and actions adopted and performed with the claimant's approval, consent and acqui-

escence, although other factors were also involved in that case." (Tr. 88, 89.)

In this connection reference is made to the following Findings of Fact and Conclusions of Law made by this court in support of its decision that action taken by the corporation and defendant subsequent to incorporation was in conflict with the pre-incorporation agreement and therefore, ratification or adoption of said agreement was never effected:

Finding No. 5. "On February 1, 1961, Chartrand made, executed and delivered to the Gaming Control Board of the State of Nevada an invested Capital Questionnaire signed and sworn to by him in which he claimed a 24% percentage interest in the operation of Barney's Club, Inc. Said document was filed concurrently with an application for a state gaming license made by B. E. O'Malia, as President of Barney's Club, Inc., in which, among the individuals listed as being interested in the operation, was C & O Investment Co., Inc., with a 51% investment in Barney's Club, Inc., parceled among Richard L. Chartrand, 45%; Bernard E. O'Malia, 45%; William F. O'Malia, 5%; and Frances L. O'Malia, 5%, which, derivatively, asserted a 24% interest to Richard L. Chartrand in Barney's Club, Inc. At that time, Chartrand and O'Malia contemplated the incorporation of C & O Investment Co., Inc. to hold their stock interests in Barney's Club, Inc., and Articles of Incorporation for C & O Investment Co., Inc., were filed on March 14, 1961. Said corporation was never fully organized or activated. Thereafter, and on April 11, 1961, Bernard E. O'Malia and Richard L. Chartrand

jointly directed a letter to the Gaming Control Board of Nevada, as follows:

> 'Permission is hereby requested to delete that portion of the application filed February 13, 1961, which reads C & O Investment Co., Inc.
>
> 'This corporation will not be formed as contemplated and the applicants will become stockholders in Barney's Club, Inc., dba Barney's Club with beneficial ownership in the latter corporation in the same percentage as they would have held had the C & O Investment Company been incorporated.' " (Tr. 68, 69.)

Finding No. 6. "In February and March, 1961, the Board of Directors of Barney's Club, Inc. was comprised of Barney E. O'Malia, Frances O'Malia, his wife, and William F. O'Malia, his son. On February 17, 1961, the Board of Directors adopted a resolution approving the issuance of 510 shares of the capital stock of the corporation to C & O Investment Co., Inc. On March 20, 1961, the Board of Directors adopted a resolution rescinding the resolution adopted February 17, 1961, and approving the issuance of capital stock of the corporation as follows: Barney E. O'Malia, 240 shares; Richard Chartrand, 240 shares, Frances O'Malia, 15 shares; William F. O'Malia, 15 shares.

"The foregoing are the only corporate minutes relevant to the stock entitlement of Chartrand before a dispute arose with respect thereto. There are no organization minutes recording the corporation's obligation at the time the real property at Stateline, Nevada, acquired for the use of the corporation, was deeded to the corporation." (Tr. 69, 70.)

Conclusion No. 2. "An adoption of a pre-incorporation agreement may be implied if the evidence shows that the corporation accepted the benefit of the agreement, with knowledge thereof and with the inferred intent that it be bound thereby." (Tr. 71.)

Conclusion No. 3. "There is no credible evidence that Barney's Club, Inc., a corporation, ever assumed or intended to be bound by the pre-incorporation agreement to the effect that O'Malia and Chartrand each receive 25½% of the authorized capital stock of the corporation." (Tr. 71.)

Conclusion No. 4. "The minutes of meetings of the Board of Directors of Barney's Club, Inc. would not be of much evidentiary weight inasmuch as the Board was then composed of O'Malia and members of his immediate family, if the resolutions of the Board then adopted were not corroborated by actions taken in implementation thereof in which Chartrand participated with respect to the applications to the Nevada Gaming Control Board for a gaming license. After the adoption of such resolutions, the applications to the Gaming Control Board and the issuance of stock conformably with the resolution adopted on March 20, 1961, Chartrand paid to the corporation the final installment ($30,000) of his $80,000 pre-incorporation subscription agreement." (Tr. 71.)

Conclusion No. 5. "The foregoing, in summary, is the most persuasive evidence adduced relevant to the responsibility of the corporation for the issuance of shares of its capital stock to O'Malia and Chartrand, respectively." (Tr. 71.)

Conclusion No. 6. "The burden of proof is upon Chartrand to establish that Barney's Club, Inc., a corporation, adopted the pre-incorporation agreement between O'Malia and Chartrand with respect to Chartrand's entitlement to 255 shares of the corporate stock." (Tr. 71.)

Conclusion No. 7. "The evidence hereinabove related creates a substantial uncertainty regarding whether the corporation received monies from Chartrand with knowledge of the pre-incorporation agreement, or whether the corporation adopted such agreement. Chartrand has not sustained the burden of proof in that respect." (Tr. 71, 72.)

Conclusion No. 8. "Richard L. Chartrand is not entitled to the issuance to him of an additional 15 shares of the capital stock of Barney's Club, Inc. by reason of the transactions referred to in the evidence and summarized in the foregoing Findings of Fact." (Tr. 72.)

Thus, it will be noted that subsequent to incorporation, the following events took place which are not compatible with the defendant's position that the corporation is bound by the terms of the pre-incorporation agreement. On February 1, 1961, defendant made, executed and delivered to the Gaming Control Board of the State of Nevada an Invested Capital Questionnaire, under oath, in which defendant claimed a 24% interest in the operation of the corporation (Tr. 69), and not 25½% which defendant now claims. On the same date an application was filed by the president of the corporation with the Gaming Control Board

of the State of Nevada in which, among the individuals listed as having an interest in the operation of the corporation, was C & O Investment Co., Inc., with a 51% investment in the corporation parcelled out in the following manner: Defendant, 45%; Bernard E. O'Malia, 45%; William F. O'Malia, 5%; and Frances L. O'Malia, 5%, which derivatively asserted a 24% interest in Barney's Club, Inc., to defendant. (Tr. 69.) Defendant and Bernard E. O'Malia had contemplated the formation of the C & O Investment Co., Inc., to hold their interests in the corporation but this was never effected. (Tr. 69.) Thereafter, on April 11, 1961, defendant and Bernard E. O'Malia jointly directed a letter to the Gaming Control Board requesting deletion of any reference to C & O Investment Co., Inc., from the application filed theretofore, and further informed the Gaming Control Board that the beneficial ownership in the corporation will be in the same percentage as they would have held had the C & O Investment Co., Inc., been incorporated. (Tr. 68, 69.) On February 17, 1961, the Board of Directors of the corporation adopted a resolution approving the issuance of 510 shares of the capital stock of the corporation to C & O Investment Co., Inc., and on March 20, 1961, this resolution was rescinded and a new resolution was adopted approving the issuance of capital stock of the corporation as follows: Bernard E. O'Malia, 240 shares; Richard Chartrand, 240 shares; William F. O'Malia, 15 shares; and Frances L. O'Malia, 15 shares. (Tr. 69, 70.) It was after the adoption of the above resolutions, the issuance of the stock, and applications to the Gaming Control Board

that defendant paid to the corporation his final installment of $30,000 under the pre-incorporation agreement. (Tr. 71.)

A case in which action taken by the corporation inconsistent with the pre-incorporation agreement was discussed is *Murry v. Monter,* 90 Utah 105, 60 P.2d 960 (1936). In that case, articles of incorporation were signed by the incorporators, including plaintiff, which provided for a different distribution of the corporate stock than that provided for in the pre-incorporation agreement. The court stated the general rule that a corporation accepting the benefits of the contract of its incorporators, with knowledge of such contract, must accept the burden. The court had this to say:

> "The general rule of law is that promoters who undertake to organize a corporation cannot bind the corporation by their contracts and agreements made before the corporation is organized. Tanner v. Sinaloa Land & Fruit Co., 43 Utah, 14, 134 P. 586, Ann.Cas. 1916C, 100; Wall v. Niagara Mining & S. Co., 20 Utah, 474, 59 P. 399, 401; 1 Thompson on Corps. (3d Ed.) § 106; 4 Cook on Corps. (8th Ed.) § 707. But that the corporation after incorporation may accept and adopt such a contract which thereupon becomes its own contract, which may be enforced by or against it. Wall v. Niagara Mining & S. Co., supra. The rule is succinctly stated in 4 Cook on Corps. (8th Ed.) § 707, p. 2894: 'A corporation accepting the benefits of the contract of its incorporators must accept the burden, and a promoter's contract which has been ratified or adopted by the corporation, or the benefits of which have been accepted

by the corporation with knowledge of such contract, may be enforced against it.'

"The corporate liability where the corporation accepts and retains the benefits of a promoter's contract is on the theory of implied contract or of estoppel. The rule is quite uniform that if a corporation with knowledge of a contract accepts the benefits thereof it will be required to perform the obligations. Gardiner v. Equitable Office Bldg. Corp. (C.C.A.) 273 F. 441, 17 A.L.R. 431, and note 49 A.L.R. 673.

"The rule of law on which defendants rely is that stated in 4 Page on the Law of Contracts, § 2492: 'A subsequent contract which does not by express terms abrogate an earlier contract, will, nevertheless, operate as a discharge thereof if it is inconsistent with such earlier contract. If the later contract does not expressly abrogate the earlier in toto, but is inconsistent therewith, the scope of the later contract determines whether any part of the earlier contract is in force. If the later contract between the parties covers the same subject-matter and has the same scope as the earlier contract, but is in whole or in part inconsistent therewith, the later contract abrogates the earlier contract in toto and is the only contract upon the subject between the parties.' See, also, Housekeeper Pub. Co. v. Swift (C.C.A.) 97 F. 290; Sherman v. Sweeny, 29 Wash. 321, 69 P. 1117.

"Defendants' reliance on this rule rather presupposes that the corporation would be liable on the contract with the promoter but for the second contract which entirely replaced the first, the scope of the two being identical and the later in-

consistent with the first contract. If plaintiff can hold the mining company, it must be on the theory that the corporation adopted the contract between Murry and Monter and made it its own or with knowledge of such contract accepted and kept the benefits. There is no evidence that the corporation by either formal or informal action adopted the Murry-Monter contract. There is no acknowledgement of the contract in the articles of incorporation or by action of the board of directors. There is no evidence tending to show that any of the incorporators other than Murry and Monter had any knowledge of the existence of the contract at the time of the incorporation, and neither of these men so much as suggested the existence of such contract until some months afterwards when Murry demanded 120,000 shares of stock from Monter. The secret knowledge of these men obtained at a time when neither had authority to bind the future corporation cannot be said to be knowledge of the corporation. Gardiner v. Equitable Office Bldg. Corp., supra. The evidence does not disclose that the corporation with knowledge of the contract accepted its benefits. The corporation was entitled to rely on the contract made with Murry in the articles of incorporation wherein he agreed to deed his interest in the mining claims for the amount of stock subscribed by him."

DEFENDANT IS BOUND BY THE FINDINGS OF FACT MADE BY THE TRIAL COURT.

The defendant is bound by the Findings of Fact made by the court below and all facts which are included in the Conclusions of Law and which are not included in the Findings of Fact. *Oregon Iron & Steel Co. v. Kelso State Bank,* 129 Wash. 109, 204 P. 569. In a Federal case, *Turner Glass Corp. v. Hartford-Empire Co.,* C.A. 7th, 1949, 173 Fed.2d 49, cert. den., 70 S. Ct. 57, 338 U.S. 830, 94 L.Ed. 505, it was held that the Court of Appeals was required to accept the trial court's findings as correct where plaintiff appealed from judgment dismissing its complaint after a trial upon the merits, and pursuant to plantiff's request that only certain questions of law be considered on the appeal, all of the oral testimony and all of defendants' exhibits were omitted from the record.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the judgment of the court below should be affirmed.

Dated, Reno, Nevada,
September 23, 1966.

Respectfully submitted,
ELI GRUBIC,
Attorney for Appellee.

Certificate

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance therewith.

Eli Grubic,
Attorney for Appellee.